

BACKGROUND, EXTENT, AND CONSEQUENCES
OF "FEDERALIZATION" OF SAVINGS AND
LOAN ASSOCIATIONS

BY

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A.B., University of Colorado, 1923

A.M., University of Illinois, 1937

AN ABSTRACT OF A THESIS

SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF DOCTOR OF PHILOSOPHY IN
ECONOMICS IN THE GRADUATE SCHOOL OF
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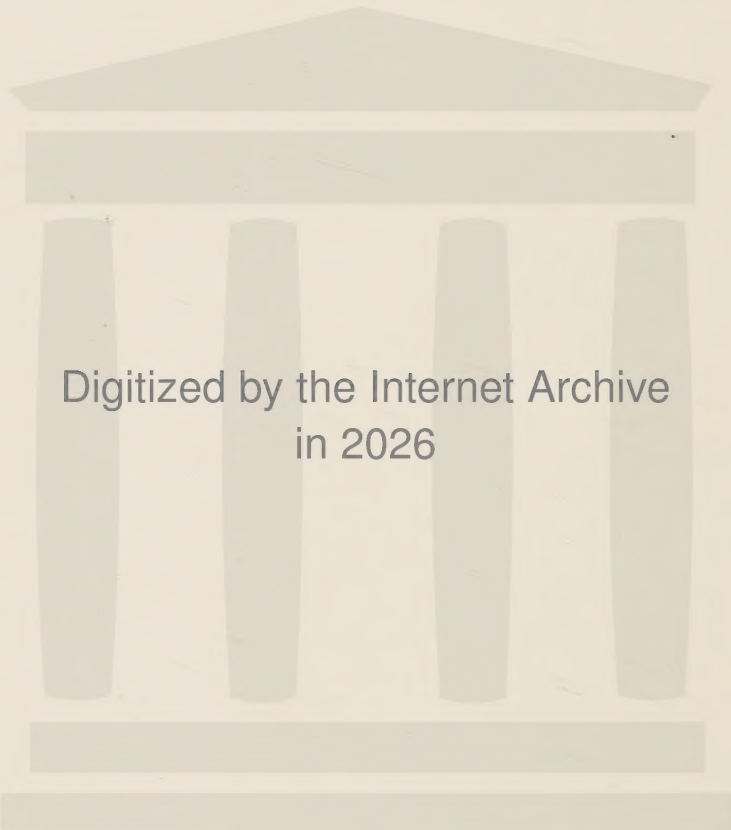
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I. INTRODUCTION

The term "building and loan association" is familiar to almost every citizen of the United States. The building and loan association is known to the majority of people as an institution to which small savers entrust their funds at a better rate of return than is offered by other savings institutions which are available to serve them. A very large number of middle class homes have been financed through building and loan associations, and by 1930 this was a business with reported assets of almost nine billion dollars.

The experience of the confident small savers in building and loan associations became, in general, increasingly unhappy during the depression years after 1930. People with mortgages on their homes had even more distressing experiences. Building and loan associations stood, disintegrating and helpless, at the center of the economic distress of thousands of borrowers and millions of savers.

After economic havoc had continued to spread for more than two years and was showing no signs of abatement, the federal government was impelled to take steps toward the relief of the millions of citizens affected. After the first fumbling attempts had proved ineffective, the device of granting federal charters to savings and loan associations, among other expedients, was brought forward to facilitate relief of the associations and their members, and to effect certain modifications in the United States savings and loan structure.

By the end of 1940 federal charters had been available to savings and loan associations for more than seven years. The time was ripe for an impersonal appraisal of the influence of "federalization" upon the savings and loan structure. Such an appraisal involves some examination of the pre-1930 practices of building and loan associations in order to judge to

what extent faults of that period were diminished by developments of the decade ending in 1940. Some study of what federalization implies and why it was considered desirable is required. Next must be ascertained the extent to which federalization has proceeded and the scope of operations of federal savings and loan associations. Finally, the influence of federalization upon all savings and loan associations must be estimated and a critical evaluation of the savings and loan position after seven years of subjection to this influence attempted.

The savings and loan association in America was originally conceived as a purely cooperative voluntary association of persons of small income who desired and intended to achieve home ownership—no others. Each was to make regular contributions to a common fund, one member after another borrowing enough to finance a home of his own as fast as the funds accumulated in the association treasury. This was in a day when what was considered as an adequate home for a wage-earner could be had at a cost seldom exceeding a thousand dollars. The home acquisitions were made by the same people—as a group—who provided the funds for this purpose, and group investment in non-movable consumers' goods did not outrun group savings for that purpose. Since all were primarily home seekers, there were few problems of liquidity or disposal of residential property which might come into the hands of the associations through defaults of the members on their obligations. When the purposes of these early associations had been accomplished, all members had acquired homes, and the group savings and earnings upon them had been sufficient to pay for all members' homes, the association was dissolved. The early associations were of this "terminating" type.

There were numerous objections to this type of association and other plans of operation were sought. A rather wide variety of plans of operation of such associations was gradually evolved. The serial plan, the permanent plan, the so-called Dayton plan, and several guarantee-capital plans came into use. The saver, with no necessary intention of

becoming a home owner, made his appearance on the membership rolls, and the original concept of the building and loan association gradually receded from view.

With the advent of permanency of association existence, the building and loan business began to fall into the hands, or under the influence, of those with ulterior interests. Lumber interests, real estate brokers and operators, speculative builders, lawyers, insurance agents, bank and trust company officials, building and loan managing officials, and others took more and more active interest in their promotion to serve selfish ends. The emphasis shifted from the best interests of the borrower to the best interests of those in effective control, which incidentally involved major consideration of the best interests of the saver. All this is glossed over in the somewhat limited literature, and popular thought concerning building and loan associations has been guided carefully toward the concept of the association in its original form of the 1830's.

II. THE COURSE OF SAVINGS AND LOAN ACTIVITY TO 1928

As background for this study, some idea of the historical distribution of the savings and loan business in the United States is desirable. The first association in this country was established at Frankford, Pennsylvania, a suburb of Philadelphia, in 1831, and the movement spread from this center. Only general facts concerning the scope of the movement up to 1893 are known. In 1893, Commissioner of Labor Carroll D. Wright made the first statistical survey of building and loan associations in the United States. This survey was remarkably comprehensive, and no such complete data on some aspects of the business have ever been assembled since.

Commissioner Wright found 5,838 associations in existence, with total membership of 1,745,725, assets of \$528,852,885, and outstanding loans of \$487,494,717. In 1893 there were thirteen states with building and loan assets in excess of \$10,000,000. These states were Pennsylvania, Illinois, Ohio, Missouri, New York, New Jersey, Indiana, California, Minnesota, Kentucky, Massachusetts, Tennessee, and Maryland,

listed in order of decreasing value of assets. These states had about 72 per cent of the total United States urban population and about eighty per cent each of building and loan members, assets, and outstanding mortgage loans. Commissioner Wright collected separate statistics for the so-called "national" associations of the time, which are included in the above figures.

The thirteen leading states in the savings and loan business of 1928 were Pennsylvania, Ohio, New Jersey, Massachusetts, Illinois, New York, Indiana, California, Wisconsin, Maryland, Louisiana, Missouri, and Nebraska, listed in order of decreasing value of assets. The savings and loan business had expanded enormously, especially during the 1920's, and by 1928 there were 12,666 associations, with nearly twelve million members, and more than eight billion dollars in assets. These thirteen states in 1928 had only 67 per cent of total urban population, but 83 per cent of the associations, 79 per cent of all savings and loan members, and 82 per cent of all association assets. Eight cities had 32 per cent of all the associations in the United States, and there were many more in their suburbs. In 1928, one out of every six urban residents of the United States was a savings and loan association member, with an average investment of \$668.

Various limited attempts to establish building and loan "reserve" systems were made after 1893. There was felt to be an especial need for creating means to give some mobility to savings and loan funds. Effective cooperation between those associations accumulating funds in excess of their loan demands and associations in a reversed position was difficult. A number of expedients, on local and state-wide scales, were tried. A state-wide scheme, covering building and loan associations in New York State, was probably the most successful. Most of the other attempts were never put into effective operation, and short life was characteristic of them.

III. THE PLACE OF FEDERAL ASSOCIATIONS IN THE HOME FINANCING PROGRAM

Excessive variance existed in savings and loan association form and practice in 1930. Exclusion of the associations

from a part in the Federal land bank structure in 1916 had been laid largely to this prevailing lack of uniformity, but little had been done since to correct it. Associations within the same states might operate on several different plans. In some states charters, laws, and supervision were quite stringent while in others these were, for all practical purposes, non-existent. Many associations carried on a part of their operations almost as commercial banks. There was a minimum of agreement upon what constituted "best" practice, and premium, withdrawal, distribution of profits, and reserve plans and policies were highly individualized. The diversity barred the way to an integrated national savings and loan structure, and the excessive individuality left the way open to a great many malpractices and abuses.

In 1930 the savings and loan associations stood at the peak of their growth. When conditions took a turn for the worse after that year the associations found themselves extremely embarrassed. Unemployment and growing distrust caused not only cessation of savers' payments on their shares, but numerous borrowers became unable to keep up their amortizing payments. Shares of the hordes of new members added after 1918 continued to mature as final payments were made, new members were seldom to be found, and withdrawal applications flooded the hapless associations. Commercial banks called the loans they had made to the associations to take away what liquidity they may have had. Cessations of borrowers' payments began to necessitate foreclosures with their attendant heavy expenses. Ever-increasing proportions of assets consisted of involuntarily acquired real estate with its added expenses of taxes, maintenance, and management.

Savers needed their funds and borrowers needed relief from foreclosures. After the creation of the Reconstruction Finance Corporation in 1932, the savings and loan interests brought their problems before Congress. The savings and loan associations had long envied the Federal Reserve system of the commercial banks. In 1919, they had brought the Calder-Nolan bill before Congress to create a similar system for building and loan associations. The bill had never been brought

to a vote. In 1932, Congress passed the Federal Home Loan Bank Act, establishing a system of twelve regional banks to meet the wishes of the savings and loan interests. A year of experience with this system demonstrated its uselessness, and a bill for repeal of the Act was introduced in Congress. A number of pressures combined to keep the system in operation but passage of the Home Owners' Loan Act in 1933 was more helpful to associations and their members than was the Federal Home Loan Bank system. In this Act the federal chartering of savings and loan associations was provided for. State legislation had held many associations out of membership in the Federal Home Loan Bank system. Now, state associations were given the opportunity to desert their state charters for federal charters which would permit membership in the Federal Home Loan Bank System. In fact, federal associations were offered certain attractive benefits which were denied state-chartered associations, but membership in the Federal Home Loan Bank system was made compulsory for them. The operations of the Home Owners' Loan Corporation and the provision for federal chartering were important factors in building up the Federal Home Loan Bank system.

With provision made for keeping people in their homes, the next Congressional step was toward attracting funds into the home financing field to stimulate recovery of the construction industry and to provide more adequate housing. The National Housing Act of 1934 provided for the insurance of funds advanced for home mortgage financing, and for the insurance of accounts in savings and loan associations. Certain governmentally-financed mortgage companies were created in the attempt to establish an organized market for home mortgages.

In 1937 Congress turned its attention to those people whose incomes promised them no possibility of financing their own homes. The Public Works Administration had constructed some 51 low rent housing projects. In 1937 the United States Housing Authority was created and given supervision over this housing. It was authorized to make loans to local housing authorities for the purpose of providing adequate housing for families of low income at rents which they could afford to pay.

When necessary, the United States Housing Authority was to subsidize projects to keep rents at low levels. This brought federal agencies into practically all fields of urban housing.

The Federal Home Loan Bank Board was given supervision over the twelve Federal Home Loan Banks, the Home Owners' Loan Corporation, the federal savings and loan associations, and the Federal Savings and Loan Insurance Corporation, thus fitting the federal associations into a place in the over-all governmental housing program.

IV. EXTENT AND DISTRIBUTION OF FEDERALIZATION

Federalization was provided for in 1933 and the period of greatest growth in number of federal associations was during 1934 and 1935. After that time the privileges enjoyed by federal associations were gradually extended to state associations, and the rate of federalization slowed down. Total savings and loan association facilities, however, continued to decline until after 1938.

A great many new federal associations had been created in areas lacking adequate home financing service, and these reached new savers and new borrowers. About an equal number of state associations converted to federal charter as their affairs could be stabilized. By 1940 the assets of federal associations exceeded those of state associations in 21 states, but only one of these states was among the leaders in aggregate federal and state association assets. Only 26 states had higher total assets in 1940 than in the year federalization was legalized, and few of these states were among the leaders. By 1940, sixteen states had higher total assets than they had in 1930, and only two of these states were among those which had led in savings and loan assets in 1930. There appeared to be little necessary correlation between degree of recovery and extent of federalization in the various states.

In 1940 the savings and loan situation was approaching a considerable degree of over-all stabilization at about two-thirds its 1930 asset level. Considering the movement of the United States Housing Authority, the Home Owners' Loan

Corporation, and the Federal Housing Administration into the field of home financing for a large part of the group formerly served by savings and loan associations, it would appear that the associations have done very well to arrest their decline at this level. Every state had at least one federal association, but some highly federalized states were still on the decline while other states with a very low degree of federalization were far above their 1930 savings and loan asset levels.

V. DISTRIBUTION OF SAVINGS AND LOAN FACILITIES, 1930 AND 1940

Because the savings and loan business has been so highly localized in character, and has traditionally appealed so strongly to the small saver and home buyer, it is not unreasonable to expect it to spread its purported services fairly evenly in proportion to urban population. The claim of the Federal Home Loan Bank Board was that prior to 1933 only 1,566 of this country's 3,072 counties were being served by home financing institutions eligible for Federal Home Loan Bank membership, and only 1,477 counties had savings and loan associations. By mid-1938, 94 per cent of all counties were said to have access to federal savings and loan associations for home financing and savings services.

A study comparing the correlation of savings and loan facilities—as measured primarily by assets—with urban population of the various states in 1930 and in 1940 revealed some interesting facts. The total United States urban population in 1940 was 108 per cent of the 1930 urban population but the total number of associations in the later year was only 66 per cent of the 1930 number, the number of members only 55 per cent, the value of assets only 64 per cent, and the volume of outstanding mortgage loans only 57 per cent.

In the comparison, nearly all of the states were found to fit into two categories, each with three sub-classes. It was ascertained that 31 states had closer correlation of savings and loan assets with urban population in 1940 than in 1930, and in eighteen, including the District of Columbia, the correspondence was poorer.

There were fourteen states with assets too low in proportion to urban population in 1930 which had improved this correlation by 1940 through absolute gains in total savings and loan assets. In eight of these states more than fifty per cent of total savings and loan assets were in federal associations.

There were eight states with assets too low in 1930 in proportion to urban population which had improved this correlation by 1940 through smaller proportionate losses in association assets than had been suffered by associations in other states. These states thus retained higher percentages of the lower 1940 total of savings and loan assets to bring their shares more in line with their shares in total urban population. In three of these states more than fifty per cent of total savings and loan assets were in federal associations.

In nine states the savings and loan assets were too high in relation to urban population in 1930 and the proportions had been brought considerably closer together by large losses in assets by 1940. In only two of these states were as much as fifty per cent of total savings and loan assets in federal associations.

Of the eighteen states with poorer correlation between urban population and savings and loan assets in 1940 than in 1930 the District of Columbia was the only one in which the proportion of assets was too high in 1930 and, because of absolute gains in assets, was still more so in 1940. North Carolina was unique in that its proportion of assets was slightly below that of its urban population in 1930, but absolute gain in assets during the decade made the proportion of assets rise above its proportion of urban population by a wider margin than it had been below the latter in 1930. Neither state was extensively federalized.

There were five states in which the proportion of assets to urban population had been too high in 1930 and the correlation was still poorer in 1940 because these states had suffered only small asset losses relative to average savings and loan asset losses. In only one of these states was as much as fifty per cent of the savings and loan assets in federal associations.

There were eleven states in which the proportions of

assets were too low in relation to urban population in 1930, and the margin between the two had been widened by losses in assets by 1940. North Dakota was peculiar in this group in that it lost so relatively little in assets that in 1940 its proportion of savings and loan assets was further above its percentage of urban population than it had been below the latter in 1930. Seven of these eleven states had more than fifty per cent of their savings and loan assets in federal associations in 1940.

Other comparisons by groups of states permit a few generalizations. When urban population and savings and loan assets were large the states had usually been over-served by savings and loan associations in 1930. The general tendency was for facilities to decline in these states, bringing closer correlation between savings and loan facilities and urban population. In general, state associations still dominated such groups of states in 1940, and federal associations played secondary roles. Proportions of borrowed money, including advances from the Federal Home Loan Banks, and United States Treasury and Home Owners' Loan Corporation investment in savings and loan shares were usually not high in relation to proportions of urban population in these states.

Where savings and loan assets and urban population had been relatively small in 1930, the states were generally under-served by savings and loan associations. In such groups of states the federal associations in 1940 were more important, either in holding absolute declines to a minimum or in contributing to absolute increases in facilities which brought them into closer proportion to urban population. Federals in these states usually relied heavily upon Treasury and HOLC share purchases and advances from the Federal Home Loan Banks for funds to use in home financing in these under-served states. Facilities in these groups of states were, in general, not raised to the level of the proportions of urban population, but were brought considerably closer.

VI. SOME CONSEQUENCES OF FEDERALIZATION OF SAVINGS AND LOAN ASSOCIATIONS

The evidence accumulated in this study shows the need for caution in pointing to federalization as the *cause* of certain developments. Unquestionably, the provision for federal chartering of savings and loan associations has been the major cause of a number of significant changes in the savings and loan sphere, but many other changes have simply occurred at the same time that federalization was proceeding, and are due, in whole or in part, to entirely different influences. The consequences of federalization can be pointed out only in conjunction with other developments.

The first year of life of the Federal Home Loan Bank system demonstrated that it was not the answer to savings and loan problems, but enough pressure was brought to bear on Congress to prevent its abandonment. Instead, the Federal Home Loan Bank Board was given instruments which could be used to bring the associations into the system while at the same time making an effective attack upon the problems to be solved. The Home Owners' Loan Corporation worked to prevent further increases in the foreclosure difficulties of the associations and to keep equity holders in their homes. However, it could do little to implement the recovery aspects of the government housing program. A federal charter for a savings and loan association carried with it certain privileges of obtaining loanable funds from government sources, along with compulsory membership in the Federal Home Loan Bank system. Since many associations were hampered by their state laws in their attempts to work their way out of difficulty, the desertion of their state charters for federal charters offered definite attractions. The HOLC helped to put many associations into condition to qualify for federal charters and the Federal Home Loan Bank system grew apace.

Pressure was thus brought to bear upon state legislatures to prevent the flight of entire state savings and loan structures to federal charter. The states revised their laws to permit state associations to join the Federal Home Loan Bank

system and to comply sufficiently with Federal Home Loan Bank Board requirements to enjoy the purported benefits of membership. By 1940, some 78 per cent of savings and loan assets had been brought under Federal Home Loan Bank influence. As state laws were modified in the desired directions, the privileges originally extended only to federal associations were granted the state associations, and by 1940 the Federal Home Loan Banks had about twice as many state association members as federal members. Pressure toward federalization had long since slackened as it became possible to bring state associations under about the same degree of control as the federals. Federalization was indirectly responsible for many changes in savings and loan activities because of its effective use in lining up such a high proportion of the savings and loan business under the influence of the Federal Home Loan Bank system, from where the preponderance of savings and loan business could be guided in desired directions by a five-man Board of Presidential appointees.

The federal associations were a strong factor in establishing a pattern of savings and loan operations which was a great improvement upon the practices of expediency and opportunism followed by so many associations heretofore. A considerable degree of uniformity, which has its desirable aspects, was achieved through pressure exerted by the federals.

It is generally admitted that the technical quality of savings and loan management has been markedly improved by federal supervision of member associations of the Federal Home Loan Bank system, especially in those associations which have their accounts insured with the Federal Savings and Loan Corporation. Whether the aim of improving the spiritual quality of savings and loan management has been achieved or not is open to some question. The federalization device has been employed extensively in the direction of creating larger associations and eliminating over-competition in regions where too many associations had forced each other into unsound practice. The larger associations have been staffed with full time personnel who now find the way to a savings and loan career open to them as a reward for their efforts in learning

approved conduct of a savings and loan business. Many petty financial charges and other abuses have been eliminated through the influence of federal associations.

Although the evidence points to a conclusion that the very small saver is, for the most part, staying out of the savings and loan association, there is not much evidence that the bulk of savings and loan investors have any real comprehension of the nature of the commitments they are making. If savings and loan associations were to be expected in the future to stand entirely upon their own feet, then foundations were being laid in 1940 for disaster eclipsing that of the 1930's, except that fewer savings and loan investors would be involved.

However, there is ample evidence that the savings and loan associations have accepted a role as wards of the government. The federal government has accepted direct and contingent responsibility for about half of the residential home mortgage debt of the United States. It retains its agencies for dealing with home mortgage distress. Some federally-encouraged practices of the present are obviously economically unsound, but politically, socially, and militarily expedient, and government agencies must stand ready to take the probable consequences of acts which they advocate. There can be little doubt, if the past is any index to the future, that most suppliers of home mortgage funds, insured or not, will receive a considerable degree of protection. Under existing conditions, home construction and financing appears to be regarded by government as primarily a social service to be rendered, and secondarily as a private business. Under cover of its purported functions as a "reserve system" for savings and loan associations, the Federal Home Loan Bank system is nothing more than a control agency devised to accept the savings and loan associations as they are, seeing their salvation and usefulness in government responsibility and benevolence.

There are ways open to the associations to get back to sound and independent practices. But they are bound by some parts of the old building and loan "principles" in their thinking. They have seemed quite willing to accept a part as pas-

sive instruments of federal housing policy, and to get what they can out of the business without assuming now the responsibilities they were never willing to assume before.

Federalization's most significant achievement has been its success as a force in whipping the savings and loan associations into their place in the government scheme of things.

The materials upon which this study and its conclusions are based are almost entirely the publications of the savings and loan trade associations, the various government agencies concerned with housing and home financing, and hearings upon matters pertaining to savings and loan associations before various Congressional committees. The writer realizes that he has been led to some unusual, and no doubt unpopular, conclusions, but the evidence seems clear enough to warrant these conclusions from the present view to be had of the unfolding of historical events.

VITA

J. Russell Boner was born in Springfield, Missouri, August 30, 1901. He attended the public schools of Missouri, Kansas, and Colorado, graduating from the Hugo, Colorado, high school in 1920. He attended the University of Colorado intermittently from 1921 to 1929, receiving the A.B. degree in 1928, and serving as an assistant in chemistry from 1927 to 1929. He left the University of Colorado in 1929 to spend seven years as teacher and administrator in Colorado public high schools.

Beginning in 1933, he attended summer schools at the University of Illinois, changing his field to economics. He left Colorado in 1936 to accept an appointment as assistant in economics in the College of Commerce and Business Administration of the University of Illinois, receiving the A.M. degree in 1937. He accepted an appointment for the Fall of 1937 in the School of Commerce and Business Administration of the University of Alabama, continuing his work toward the doctorate in summer schools at the University of Illinois until all course work had been completed.

He was granted leave of absence from the University of Alabama for the academic year 1941-42 to accept a second appointment as assistant in economics at the University of Illinois while completing his residence requirement and dissertation for the Ph.D. degree. He resigned his position at the University of Alabama in the Spring of 1942.

